

Bankruptcy and Family Law Amendments

Outline of Chapter

- 4.1 In this chapter of the report the following issues are considered:
- Support for the proposed change.
 - Criticism of the proposed change, namely that -
 - ⇒ the proposed change raises jurisdictional issues;
 - ⇒ the proposed change would result in an increased burden on trustees; and
 - ⇒ the combined effect of the Schedule 1 changes (discussed in previous chapter) and these proposals is that couples may be encouraged to separate.
 - The Committee's concerns in relation to the proposed change.
 - The Committee's conclusion and recommendation.

Background

- 4.2 Schedule 2 of the draft Bill proposes changes to both the Act and the *Family Law Act 1975* to clarify the respective rights of the trustee and the non-bankrupt spouse when family law and bankruptcy proceedings exist at the same time.

4.3 The proposed changes will address the following three scenarios:

- Bankruptcy after separation and prior to property being finally dealt with under the *Family Law Act 1975*. The draft Bill contains amendments to provide that:
 - ⇒ if a party becomes bankrupt in the course of family law proceedings, the rights of the trustee will be subrogated to the trustee in bankruptcy;
 - ⇒ the trustee will become a party to the proceedings;
 - ⇒ in any proceedings before the court, the trustee will stand in the shoes of the bankrupt spouse and will have all the rights which the bankrupt would otherwise have in relation to the property proceedings. This will enable the trustee to put submissions in relation to the claims of creditors; and
 - ⇒ the non-bankrupt spouse will have the right to continue the proceedings against the trustee.
- Bankruptcy after separation and subsequent to property being (finally) dealt with under the *Family Law Act 1975*. The draft Bill contains amendments to provide that:
 - ⇒ where orders have been made by the Family Court but not implemented prior to bankruptcy, the doctrine of relation back may continue to apply; and
 - ⇒ the trustee may bring an application to have the proceedings re-heard to take into account the interests of creditors where those interests had not been properly considered.
- Separation after bankruptcy, but prior to property being finally dealt with by the trustee in bankrupt. The draft Bill contains amendments to provide that:
 - ⇒ where a couple separates after one party has become bankrupt but during the period of bankruptcy, the non-bankrupt spouse may seek to have his or her interest in the property recognised and a distribution from the bankrupt estate of any property which has not been dealt with;
 - ⇒ for reasons of certainty, no claim can be made against property that has already been distributed by the trustee; and
 - ⇒ the Family Court would deal with this claim.

4.4 The Attorney-General's Department stated that the interaction between family law and bankruptcy had been a 'vexed issue' since

1975 (the year that the *Family Law Act 1975* was introduced) and described the proposed change in the following way:

The Bill will effectively merge the Family Court's jurisdiction on bankruptcy and family law matters in cases where these areas interact, and the amendments will allow the Family Court to consider the non-financial contributions of a non-bankrupt spouse for the acquisition of family property.¹

Support for the Bankruptcy and Family Law Amendments

4.5 There was some support for this proposal. The FLS of the LCA expressed support for the proposed change but identified conflicting views within the LCA:

This legislation, at Schedule 2, has probably gone a little bit further than we had expected, so it takes into account all of the considerations under the Family Law Act claim, including needs considerations. So we are not unhappy about Schedule 2, but the insolvency side of the Law Council of Australia is less comfortable with it.²

Criticism of the Bankruptcy and Family Law Amendments

4.6 The following criticisms were raised in relation to this proposal:

- that the proposal raises jurisdictional issues;
- that the proposed change would result in an increased burden on trustees; and
- that the combined effect of the Schedule 1 changes (discussed in previous chapter) and these proposals is that couples may be encouraged to separate.

1 AGD, *Transcript of Evidence*, 6 July 2004, p.11.

2 The FLS of the LCA, *Transcript of Evidence*, 6 July 2004, pp.92-93.

Jurisdictional Issues

- 4.7 Some submitters expressed concern that the Family Court would lack the expertise necessary to deal with bankruptcy issues. The proposed change would allow the Family Court to adjudicate on bankruptcy matters in each of the three scenarios outlined above. So, for instance, where a party becomes bankrupt in the course of property proceedings in the Family Court, the Court would have to reconcile the competing claims of the non-bankrupt spouse and the trustee in bankruptcy. The IPAA stated that:

It is a fact that family law practitioners and judges have very limited experience in the law and practice of bankruptcy. Given the family law's focus on non-financial contributions to a matrimonial arrangement, this will in all likelihood throw up erroneous applications of bankruptcy law. This will, in turn, lead to confusion in the proper application of the Bankruptcy Act.³

- 4.8 The NNWLS suggested that the Family Court be granted exclusive jurisdiction to deal with cases where bankruptcy and family law issues overlap, because:

... the different approaches to the laws of bankruptcy and family law may mean that women and children are better served by the Family Court which is used to prioritising the needs of dependants.⁴

- 4.9 The IRC of the LCA suggested that these proposed changes apply also to de facto couples and those in same sex relationships, and that the Federal Court should deal with all these cases:

As the Family Court is established under the marriages power of the Constitution, that court could not deal with bankruptcy as it applies to the property of the person in de facto or same sex relationships. Logically therefore, if the Government is bent on applying FLA principles to bankruptcy, those provisions should be incorporated into the Bankruptcy Act. It follows that, if a superior court is to be vested with jurisdiction, it is the Federal Court, rather than the Family Court, which should deal with all relationships, as little purpose would be served by allowing the Family Court

3 IPAA, *Submission 69*, p.9.

4 NNWLS, *Submission 108*, p.8.

to deal with the property of married or formerly-married spouses and the Federal Court to deal with the property of persons in other relationships.⁵

- 4.10 However, the FLS of the LCA suggested that the appropriate forum would most likely be determined on a case by case basis:

I am suggesting there would be instances where the Family Court would say , 'The primary issue between the parties here are going to concern the trustee in bankruptcy, and the Family Law Act provisions will be very ancillary to the Federal Court'. In another case it might be that there are all sorts of complicated Family Law Act issues, maybe even collateral children's issues, child support and so on. I imagine the Federal Court might well say, 'This is not for us. We appreciate that there is an insolvency issue there, a bankruptcy issue. Perhaps the Family Court ought to deal with that'.⁶

Increased Burden on Trustees

- 4.11 The IPAA identified resource issues in relation to the proposed change:

We also question who will fund the Trustee to be represented in Family Law Court proceedings, particularly in the circumstance where all of the material assets of the Bankrupt Estate are subject to the Family Law Court proceedings? In this instance, the Trustee is not guaranteed of a successful or partially successful result to enable him or her to pay for his or her representation work in the proceedings, or pay for legal counsel.

Further, Bankruptcy Trustees are not family law experts. Accordingly, where family law proceedings are on foot or being actively contemplated, Trustees will need to obtain expert advice on the family law implication on the Bankrupt estate. This will be an added burden on the Bankruptcy Estate and further, there is no guarantee that the Bankrupt Estate will have sufficient funds at its disposal to obtain such advice.⁷

5 The IRC of the LCA, *Submission 98*, pp.33-34.

6 The FLS of the LCA, *Transcript of Evidence*, 6 July 2004, p.94.

7 IPAA, *Submission 69*, p.10.

Incentive for Couples to Separate

- 4.12 Some submitters expressed concern that the combined effect of this and the Schedule 1 proposed changes was that couples would be in a better financial position if they separated. Mr Suryan Chandrasegaran suggested that there was a potential problem with allowing the trustee to ‘step into the shoes of a bankrupt spouse’ in family law property proceedings:

...the Bill does this without removing the Court’s powers to consider the maintenance needs of the non-bankrupt spouse or the interests of the children of the couple. For example, the new section 72(2) will allow the Family Court to order transfer of vested property to the non-bankrupt spouse to fully or partially satisfy any maintenance claim. Proposed section 79(1)(d) allows the Family Court to make orders requiring the relevant bankruptcy trustee to make ‘for the benefit of...a child to the marriage’, such transfer of property as the court determines.

The Family Court thus has the power to take into account the needs for maintenance of the non-bankrupt spouse and the children of the marriage. These are powers the Federal Court does not have in dealing with a normal bankruptcy application. The Federal Court must only look at the specific factors listed in section 139F(1)...It cannot take into account the hardship which would be suffered by the non-bankrupt spouse or children if property (such as the family home) is sold up.

Under this Bill, a couple and their children would be better off if they separated or divorced when bankruptcy become imminent.⁸

- 4.13 This ‘objectionable outcome’ was also raised as an issue by Arnold Bloch Liebler:

The effect of the Bill could be to force families to contemplate divorce or property settlement to protect their assets or wealth. Schedule 2 of the Bill exempts property the bankrupt is required to transfer under an agreement pursuant to Part VIII of the *Family Law Act* from being divisible property under the Bankruptcy Act (e.g. property settlements,

8 Mr Suryan Chandrasegaran, *Submission 116*, pp.4-5.

maintenance agreements). A spouse may obtain a more beneficial division of the family assets upon divorce than a court may allow under ordinary Division 4A bankruptcy proceedings where there is no divorce.⁹

4.14 Similar concerns were raised in the public hearings.¹⁰

Other Issues

4.15 The FLS of the LCA suggested that there were a number of technical issues with the amendments proposed to the *Family Law Act 1975*.¹¹

4.16 The NNWLS suggested that, as the proposed changes will require the bankruptcy trustee to be joined to certain family law proceedings, safeguards must be put in place to protect the privacy of those involved:

We note that the Bill requires the bankruptcy trustee to be joined as a party in family law proceedings in certain circumstances. However, it must be noted that there are significant issues of privacy, confidentiality and safety which are relevant in the family law but may not be so apparent to persons and agencies operating in the commercial world. Secrecy of address of a wife who has escaped domestic violence, privacy regarding her place of work etc, are of critical importance.¹²

4.17 The IRC of the LCA suggested that any 'legislative carve-out' of the bankrupt's property must fall within the parameters of sub-section 116(2) of the Act (which defines that property of the bankrupt that will not be divisible amongst creditors) and should only take place after general review of what property should be exempt from vesting in the trustee- 'In this way such carve out can be balanced against such other matters as income and superannuation and the interests of creditors generally'.¹³ This point was also raised by the IRC of the LCA in the public hearings.¹⁴

4.18 The NNWLS expressed concern that a spouse may lack adequate access to legal resources to make a claim on the bankrupt's property:

9 Arnold Bloch Liebler, *Submission 97*, p.16.

10 AFCCRA, *Transcript of Evidence*, 6 July 2004, p.38.

11 See the FLS of the LCA, *Submission 98*, pp.8-9.

12 NNWLS, *Submission 108*, p.9.

13 The IRC, of the LCA, *Submission 98*, p.33.

14 The IRC of the LCA, *Transcript of Evidence*, 6 July 2004, p.76.

We are also concerned that the trustee will have the resources to run complex legal proceedings but this may be impossible for a spouse- particularly one who has recently been through Family Court proceedings. There is almost no legal aid available for property matters so even the legal fees could take away a home a mother has just secured for her children.¹⁵

The Committee's Concerns

- 4.19 A concern of the Committee is in relation to the jurisdictional aspects of this proposal. For instance, one element of the proposal is that where a couple separates after one party has become bankrupt but during the period of bankruptcy, the non-bankrupt spouse may seek to have his or her interest in the property recognised and a distribution from the bankrupt estate of any property which has not been dealt with. This matter would be heard in the Family Court. However, couples who are not married do not have access to Family Court proceedings. Under these proposals, a non-bankrupt partner in a de facto relationship would not be able to have his or her interest in the property of the bankrupt recognised. In confining its application to circumstances where bankruptcy and family law matters co-exist, the net effect of the Schedule 2 is to exclude whole classes of individuals from these proposed changes.
- 4.20 The Committee notes the advice given in public hearings that the Commonwealth is seeking a referral of State jurisdiction to enable the Family Law Court to deal with de facto relationships but not same sex couples.

Conclusion

- 4.21 The Committee recognises the importance of addressing the problems arising from the interaction between family law and bankruptcy and recommends that these proposed amendments be implemented.

¹⁵ NNWLS, *Submission 108*, p.9.

Recommendation 4

- 4.22 The Committee recommends that the amendments proposed in Schedule 2 of the draft Bankruptcy Legislation Amendment (Anti-Avoidance and Other Measures) Bill 2004 be implemented.**